10. NPO Taxation under the proposed Tax Code - 4
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audit Able

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In the previous issue, we discussed how taxable income is to be computed. We now discuss its components in detail.

Gross Welfare Receipts

Definition of income of an NPO has never been clear from the Income Tax Act. This has led many tax advisers to exclude grants from income, treating these as a contract liability. The tax code tries to clear this up by emphasizing gross receipts[1]. These will consist of:

- Voluntary contributions
- Rent
- Income from incidental business activity
- Sale consideration of an investment asset[2] or a business capital asset
- Income from investments
- Any incoming, realization, proceeds, donation or subscription.

The last clause is wide enough to include all kinds of grants and other contractual receipts. Receipt of loans, borrowings and advances have, however, been excluded from the definition of gross receipts.

Gross Outgoings

These will consist of[3] :

- Contributions earmarked for Corpus
- Payments related to fund-raising, incidental business activity or for earning any receipts
- Payments for welfare activities
- Payments for capital assets
- Payments to other NPOs engaged in similar welfare activities

In addition to the above, notified[4] NPOs can claim deduction for money spent outside India on promoting notified types of international welfare. This has been discussed in more detail under a separate heading.

Capital Gains

These will be calculated in the normal manner, on the basis of sections 44 to 53.

No Accumulation or Carry-forward

NPOs are free to accumulate any amount, as long as they pay a 15% tax on it first! There is no scope for any carry-forward of unspent balances without paying a tax. You cannot make a provision for unspent grants also, as income will be calculated on cash basis[5].

This is going to create serious problems for most NPOs. If an NPO is unable to spend its grant income in the same year due to operational reasons, it will face a tax liability. If the grant is received

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late, say in March, the NPO will again face a tax liability. Further, if an NPO is to use up all the cash by end of March, how will it continue its operations in April?

Similarly, a donor agency, which gives grants to other NPOs, will end up paying tax unless it disburses all funds by March. Alternatively, it will need to create a tax-paid fund or a Corpus for working capital.

In practice, this may also give rise to number of dubious accounting practices. Some may try to make payments for expenses of April and May in advance. Others may pay out the money to selected staff as additional salary before March, and then take it back as donation after April.

Carrying forward a Deficit?

What happens if the outgoings are more than the inflow in a particular year? A deficit will result. However, there seems to be no provision for carrying this forward to the next year.

What does this mean? If an NGO borrows money from outside, or from its corpus to support a project in FY 1, a deficit will result. When it gets the grant income in FY 2, and repays the loan (or replenishes the Corpus), it will end up with a surplus, as far as Income Tax is concerned. It will then have to pay a tax of 15% on this 'surplus'!

4. Spending Outside India

Can Indian NPOs spend money outside India? As the Indians have spread across the world, this question has become relevant. Yet, the answers have not been clear. The new Code makes some important changes in this.

On International Welfare

The present Act does allow NPOs to spend money outside India. However, some conditions need to be fulfilled[6] for this to happen, including an order by the CBDT. The procedure for getting this order has been laid down. As a result, NPOs have either refrained from expanding outside India, or have done it quietly, with the ever attendant risk of disallowance.

The proposed code clears this up through section 90(g)[7]. An NPO planning to spend money outside would need to apply to the Central Government. The Government will then publish a notification in the Gazette, provided the work is such that it promotes international welfare in which India is interested.

On Permitted Welfare Activities

Does this mean that an NGO would need to apply for permission every time it wants to hold a workshop or send a patient for treatment abroad? No. This permission appears to be necessary only if two conditions are present:

1. Money is being applied outside India; and
2. It is being applied for an activity which promotes international welfare.

Apparently, this means that there is no need to get permission from CBDT, if the activity is related to any permitted welfare activity, covered by Sec. 96(g). In such a case, it does not matter whether the money is spent in India or outside India and whether the beneficiaries are in India or Africa.

Thus, in what appears to be a major relaxation, the Code has deleted the phrase 'to the extent to which such income is applied to such purpose in India' (presently part of section 11(1)(a)). This was the phrase which forced Indian NPOs to restrict their activities to India.

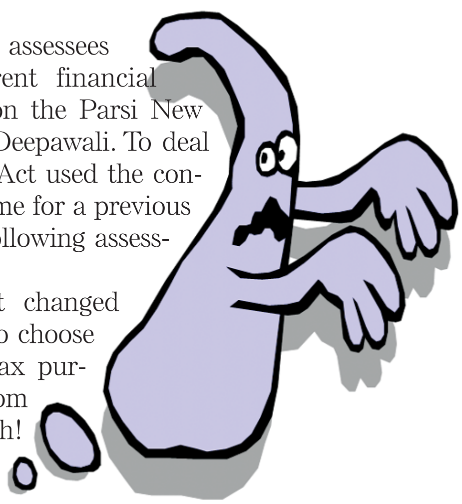
Other Changes

There are several other changes as well. Some of the important ones are discussed below.

1. Financial Year

There was a time when assessees were free to have different financial years. Some might start on the Parsi New Year, others might prefer Deepawali. To deal with this, the Income Tax Act used the concept of previous year. Income for a previous year was assessed in the following assessment year.

Later, the Government changed the law. People were free to choose any accounting year for tax purposes, so long as it ran from 1st April to 31st March!



While this sounded a little tyrannical, it ended the merry-go-round of loan entries from one assessee to another.

As a result of this change, the relevance of two different terms, previous year and assessment year, ended. However, the usage of these terms continued, because the law did not change.

In this code, the ghosts of previous year and assessment year, will finally be laid to rest. The Code will use only a single term - financial year. The financial year will run from 1st April to 31st March next. Income for one financial year (e.g. 2011-12) will be assessed on the basis of the law as it stands on 1st April of the following financial year (2012-13).

2. Registration

All NPOs will now be required to register under section 93 as soon as they start receiving any income. If they do not register, their income will be taxable @ 30% as an ordinary society. At present, they need to register[8] only when their income crosses Rs.150,000.

Decision on an application for registration should be taken within three months[9]. The wording of section 93 has been modified. It is no longer compulsory for the Commissioner to call for information[10]. It is also not necessary for him to hear the applicant before rejecting the application[11].

If the application is rejected, an appeal will have to be made to the Income Tax Appellate Tribunal[12]. As ITAT appeals are costly, a newly formed charitable organisation may need to think hard before appealing.

3. Accounting on Cash Basis

All NPOs will be required to prepare accounts for welfare activities on cash basis for tax purposes[13]. This means that the emphasis will now shift to the Receipts and Payments Account in all cases.

However, this does not mean that accounts for incidental business activities can be prepared on accrual basis. Reading section 88(1)(a) with section 89(1)(c), it appears that income from business activities are subsumed within the welfare activities. Therefore, accounting for business shall have to be on cash basis.

This will also apparently create a conflict with ICAI recommendation[14] that an NPO carrying on any business activity should maintain accounts on accrual basis.

...Continued in Auditable 11

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[1] Sec. 89: (1) The gross receipts from the permitted welfare activities referred to in sub-section (2) of section 88 shall be the aggregate of the following, namely:-
(a) the amount of voluntary contributions received;
(b) any rent received in respect of a property consisting of any buildings or lands appurtenant thereto;
(c) the amount of income derived from any business carried on by it, if-
(i) the business is incidental to the permitted welfare activity so carried on; and
(ii) the permitted welfare activity so carried on does not involve any activity referred to in sub-clause (vi) of clause (g) of section 96;
(d) full value of the consideration received from the transfer of any investment asset, not being a financial asset;
(e) full value of the consideration received from the transfer of any business capital asset, if-
(i) the business is incidental to the permitted welfare activity carried on by it; and
(ii) the permitted welfare activity so carried on does not involve any activity referred to in sub-clause (vi) of clause (g) of section 96;
(f) the amount of any income received from any investment of its funds or assets; and
(g) the amount of any incoming, realization, proceeds, donation or subscription, received from any source.

(2) The gross receipts referred to in sub-section (1) shall not include,-
(a) any loan, borrowings and advances during the financial year; and
(b) any receipt which is includible in clause (b) of sub-section (1) of section 88

[2] "investment asset" means any capital asset which is not a business capital asset; [sec. 284(151)]

[3] Sec. 90: The amount of outgoings referred to in section 88 shall be the aggregate of -
(a) Voluntary contributions received during the financial year by the non-profit organisation made with a specific direction that they shall form part of the corpus of the non-profit organisation.
(b) the amount actually paid during the financial year for any expenditure, not being a capital expenditure, incurred wholly and exclusively for earning or obtaining any receipts referred to in section 95;
(c) the amount actually paid during the financial year for any expenditure, not being a capital expenditure, incurred for the purposes of carrying out the permitted welfare activity;
(d) the amount actually paid during the financial year for any capital expenditure for the purposes of any business, if-
(i) the business is incidental to the permitted welfare activity carried on by it; and
(ii) the permitted welfare activity so carried on does not involve any activity referred to in sub-clause (vi) of clause (g) of section 96;
(e) the amount actually paid during the financial year for any capital expenditure in relation to any investment asset, not being a financial asset;
(f) any amount, other than any loan or advance, actually paid during the financial year to any other non-profit organisation engaged in similar permitted welfare activity;

[4] Sec. 90(g). See separate heading for a discussion

[5] Sec. 88(2)

[6] Sec. 11(1)(c) of the Income Tax Act, 1961

[7] Sec. 90 (g): any amount applied outside India during the financial year, if-
(i) the amount is applied for an activity which tends to promote international welfare in which India is interested; and
(ii) the non-profit organisation is notified by the Central Government in this behalf.

[8] Under equivalent sec. 12A

[9] From the end of the month in which the application was made

[10] Comparison of present section 12AA(1) with proposed section 93

[11] Present proviso to section 12AA(1) dropped

[12] Sec. 93, read with sections 183 and 188

[13] Section 88(2)

[14] Please see p. 4, AccountAble 6: Indian Accounting Standards, available at www.AccountAid.net

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Printed and published by Ms. Sanchita Chakraborty for AccountAid India, New Delhi. Ph. 26343128, at PRINTWORKS, F-25, Okhla Industrial Area, Phase 1, New Delhi. Ph:9810653101

Content: Shri Sanjay Agarwal, with inputs from CAs Hafez Dalal (Ahmedabad), Suresh Kejriwal (Kolkata), and Atul Trivedi (Ahmedabad)

Editing and Graphics: Ms. Sanchita Chakraborty

Designed by Ms. Moushumi De